Discussion of “The Federal Reserve’s Framework for Monetary Policy – Recent changes and New Questions”

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Paper presented at the 14th Jacques Polak Annual Research Conference
Hosted by the International Monetary Fund
Washington, DC—November 7–8, 2013

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DISCUSSION OF “THE FEDERAL RESERVE’S FRAMEWORK FOR MONETARY POLICY”

By English, López-Salido, and Tetlow

Christina Romer
IMF Annual Research Conference
November 8, 2013
Paper’s Research Strategy

• Mini FRB/US model.

• Start at current conditions

• Find optimal monetary policy conditional on a loss function that includes a cost to changing the funds rate rapidly.

• Simulate model under a number of possible rules for the funds rate.
Results for Nominal GDP Targeting

- Model nominal GDP path target as just another rule for the funds rate.

<table>
<thead>
<tr>
<th>Rule</th>
<th>Equation</th>
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<tbody>
<tr>
<td>Taylor (1993) rule</td>
<td>( R_t = r r^* + \pi_t + 0.5(\pi_t - \pi^*) + 0.5 \text{gap}_t )</td>
</tr>
<tr>
<td>Taylor (1999) rule</td>
<td>( R_t = r r^* + \pi_t + 0.5(\pi_t - \pi^*) + \text{gap}_t )</td>
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<tr>
<td>Inertial Taylor (1999) rule</td>
<td>( R_t = 0.85R_{t-1} + 0.15(\pi_t - \pi^*) + \text{gap}_t )</td>
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<tr>
<td>First-difference rule</td>
<td>( R_t = R_{t-1} + 0.5(\pi_{t+3</td>
</tr>
<tr>
<td>Nominal income targeting rule</td>
<td>( R_t = 0.75R_{t-1} + 0.25(\pi_t + \gamma n_{t+4</td>
</tr>
</tbody>
</table>
How is the analysis too narrow?

1. Assumes credibility of monetary policy.
   - Exactly what may be most important about a nominal GDP level target is that it builds credibility.
   - It is a form of communication and commitment device.
Expected Inflation in the 1930s

Source: Hamilton, “Was the Deflation During the Great Depression Anticipated?”
How is the analysis too narrow?

2. Nominal GDP target is more than a rule for the funds rate.
   - It is a commitment by the Federal Reserve to do whatever it takes to return to the path.
   - Would lead to the use of other tools.
How is the analysis too narrow?

3. Data revisions are unlikely to be an insuperable impediment.
   - Data revisions are an issue with any rule.
   - There are surely work-arounds.
Directions for Future Research

• Work on what determines credibility and, hence, what actually moves expectations.

• Work on the determinants of inflation behavior.

• Data-intensive, empirical and historical research.